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Supreme Court of the United States

October Term—1921

No. 257

CHARLES D. NEWTON, as Attorney-General of the State of New York; EDWARD SWANN, as District Attorney of New York County; and LEWIS NIXON, constituting the Public Service Commission of the State of New York, for the First District,

Appellants,

vs.

CONSOLIDATED GAS COMPANY OF NEW YORK, *Respondent.*

REPLY BRIEF ON BEHALF OF THE APPELLANT NEWTON.

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Supreme Court of the State of New York,

CHARLES D. NEWTON, as Attorney-General of the State of New York; EDWARD SWANN, as District Attorney of New York County; and LEWIS NIXON, constituting the Public Service Commission of the State of New York, for the First District, Appellants, *vs.* CONSOLIDATED GAS COMPANY OF NEW YORK, Respondent.	October Term 1921 No. 257.

Reply Brief on Behalf of the Appellant Newton.

The general brief of respondent was received by Appellant Newton on November 5, 1921, and its brief on the facts and incidental question of law, consisting of 495 pages, was received November 7, 1921.

Time will not permit Appellant Newton to make a detailed reply to the various contentions made in said briefs. We would like to have it understood by the court that because we have seen fit, in the few days allowed, to make reply to only a few of the erroneous arguments and statements expressed in the respondent's brief, that these are not all that deserve comment. If the practice of this court

would permit, we would like ample time to prepare a full and complete answer to every contention made by respondent.

Respondent's brief on the facts is profuse in the claim that the court below resolved every doubt against the company and in favor of appellant. This claim is repeated and reiterated throughout its voluminous brief.

It professes to be greatly injured by the treatment it received at the hands of the court below. The emptiness of this claim will readily be realized when attention is called to the fact that it did not file a single exception to the master's report, or a single assignment of error to the decree of the court below in the particulars complained of. (The only assignment of error filed by it relates to certain provisions in the decree see appeal—Record Case Nos. 258, 288).

We submit that it was the appellant who received the "severe" treatment both from the special master and the court below, and consequently, we have appealed to this court to rectify the many grievous errors. Respondent throughout its brief, has endeavored to secure a reversal of the decision of the court below concerning many of its rulings, but this, we submit, it may not do because it has not appealed from the decision, aside from the further fact that there is no merit in its various contentions.

The following will illustrate and sustain our contention that the court below was "severe" in its treatment of the appellants.

Renewals and Replacements.

On page 11 of the brief on the facts, it sets forth alleged cost of gas in cents per M as proved by it, and as found by the master and the court below.

It will be noted from the table there printed that in one item alone "Renewals and Replacements," the court below found the "irreducible minimum," 03.73 cents, while the company itself claimed only 03.50 cents and the liberal master allowed 03.00 cents.

Upon this question the master said:

> "We then have the question of renewals and replacements. Counsel for the complainant asks me to find that this item of expense is at least three and a half cents (3½c.) per thousand cubic feet. He contends that the record shows that the actual cost is about that figure. His contention, however, is based upon the renewals and replacements, of the Manhattan plants. I think a better result will appear when the Manhattan and Astoria plants are combined; and in my judgment, as I have indicated in my findings, three cents per thousand cubic feet will fairly cover the item of renewals and replacements" (54a).

Instead of taking the amount allowed by the master of 03.00 cents, the court below raised the amount to 3.73 cents (p. 171a), although as we say no exception was filed by the company to the master's allowance in this or any other particular. Surely, this is not resolving "every doubt" in favor of the appellants.

Federal Income Tax.

The master very properly made no allowance for Federal Income Tax for the respondent made no claim before him that it should be included as a proper operating expense (pp. 7559, 8264, 5806). Yet the court below added for this tax $350,000 in 1918, and over $230,000 in 1919 (pp. 170a, 182a).

It is not "severe" treatment to the respondent

to grant it a large item not even claimed and not raised by an exception in the court below. The propriety of allowing this item has been argued in our main brief (pp. 73-78). Such a tax was disallowed by District Judge Mayer in *New York & Queens Gas Company* v. *Newton, et al.*, 269 Fed. Rep., 277, and by District Judge Hutchinson in the case of *Galveston Electric Co.* v. *City of Galveston*, 272 Fed. Rep., 147. Yet respondent maintains now that it should be included (pp. 250-253 of its brief on the facts).

Loss Caused by Selling Gas to the City at 75 Cents.

The failure of the court below to recognize that a deficiency below the statutory rate of 80 cents was in some measure attributable to the lower rate of 75 cents per M paid to the company by the city, and to charge this deficiency to the company's private consumers is certainly not paring items down unsparingly.

Judge Mayer, in the case of *New York & Queens Gas Co.* v. *Newton, et al.* (*supra*), recognized the injustice of charging the private consumers with such loss.

Uncollectible Bills.

The allowance of $95,330.22 in 1918, and $47,535.08 in 1919 (see p. 81 of our main brief) when the legislature has fortified the company against such loss by allowing the collection of a deposit equal to two months' consumption of gas in advance of service, cannot be said to be "severe," to the respondent. On the contrary, it is resolving all doubt against the consumer. There should be no allowance for it in a case of this kind.

Rate Case Expenses.

Some rate case expenses have been included in the cost of making and distributing gas, by the court below (166a). This is certainly not an effort to reach an "irreducible minimum," as claimed by respondent.

Mr. Justice Greenbaum, in the case of *Kings County Lighting Co.* v. *Lewis*, 110 Misc. Rep. (N. Y.), 201, had previously rejected such an item as a proper operating expense.

In the case of *New York & Queens Gas Co.* v. *Newton* (*supra*), District Judge Mayer says:

> "Expenses of litigation: These were also excluded by the master but were allowed by the court in the Consolidated Gas case. I should follow the decision on this point in the Consolidated Gas case, were it not that I am firm in the conviction that, while this item may properly be considered in fixing a rate, it is not to be included in determining whether the rate is confiscatory."

Since the ruling in the case last mentioned the gas companies themselves omit this item as an operating expense in cases of this kind.

Officers' Services to the United States Government.

The court below, through a misunderstanding, thought that he need not consider this item. We have argued it fully in our main brief (pp. 115, 116). The point about it is that the amount of $36,728.50 was due the company from the government for services of company's officers and employees. Judge Hand said it did not appear on complainant's Exhibits 364, and 365. In this he was correct, the point being that it should appear

there as a credit and hence we complain of the failure to make a clear credit of this sum to the cost of making and distributing gas for that year. It should be included the same as any other credit.

Reasonable Proportions of Coal Gas and Water Gas Production.

Appellants contended that the company should have increased the output of the less costly coal gas plants in the year 1918 and proved that a reasonable and fair proportion was 50% coal gas and 50% water gas.

The court below was favorably impressed with our contention for the computations as to production expenses are based both on such percentages as well as the 22 per cent. coal gas and 78% water gas, actually produced but complained of by appellants.

The court said (p. 161a):

> "If the proper percentage between coal and water gas be half and half, this figure (.4334 for the combined gas) would be .4270."

After making this calculation which, if adopted, would have resulted in a large saving, the court said no more about it, but for some unexplained reason abandoned the proportion more favorable to this appellant.

In spite of the disregard of our contention without further comment by the court, respondent still reiterates that every doubt has been taken in favor of the appellant.

In this complex case we point out these few items all clearly deductible and easy to understand, to show this court that though the court below supposed that it treated respondent harshly, and respondent now contends that it has been

severely dealt with and the operating expenses pared to the bone, so to speak, still a careful analysis of the decision shows that the court has been extremely liberal to respondent and far more liberal than any court rendering a decision in a confiscatory case before or since this decree.

The extent of the extravagant claims made by the respondent probably was not fully realized by the court below, for it stopped short, evidently weary with the stupendous task before it. Perhaps respondent surmised this would be the result of its many and various doubtful claims of expense.

The exclusion of only these items of expense, conceded by respondent or weakly argued in its brief, is sufficient to uphold the statute in question, even without recourse to the many other valid contentions we make in our main brief.

Franchises.

In the prior suit (*Consolidated Gas Company* v. *Willcox*, 212 U. S., 19, p. 20) Mr. Justice Peckham made the following announcement or findings and conclusions of law set forth in the footnotes:

> "The state should not now be heard to question the value of the franchises at the time of the consolidation. *The method of arriving at the value of these kinds of franchises, and how they should be generally tested in fixing of rates are questions not now before the court and are left undecided.*"

In the instant case appellants make no attack upon the value of the franchises *at the time of the consolidation* (1884). We do, however, strongly attack the value of the franchises at the time of this action. As we view the prior decision this question, as well as the method of arriving at that value, are questions left undecided in the prior suit.

We argued fully in our main brief (pp. 182-190) that respondent's franchises have expired since the prior suit, and that it was erroneous to place a value of $7,781,000 upon such non-existent rights. The burden of proving the value of its franchise was upon respondent.

We submit that this court never intended that the valuation of the franchise in 1884 should be fastened forever upon the consumers. The respondent did not assume the burden of proving its present value. To say that the value is now the same as in the prior suit without proof of such fact is not according the severe treatment to the respondent which it so profusely complains of.

The "Fair Value" of Respondent's Property.

In its direct case, respondent offered as its proof of value the reproduction value of its plant in 1906 plus additions and less withdrawals since that time.

Appellants contended that the original cost of the property should be given greater weight than other elements and was a fairer indication of the actual investment of respondent.

In rebuttal (after an indication that the master was laying great stress upon the actual investment theory) respondent offered its book cost, inflated many millions at the time of the consolidation in 1884.

The special master seized upon these book figures offered in the latter days of the trial and supposed they represented the actual investment upon which he concluded to base the value of respondent's property. Appellants do not quarrel with the master that the bona fide investment, is an equitable basis on which to determine fair value, but we do disagree with the manner in which the master deter-

mined his so-called investment. We contend that the original cost of the property, when depreciated, more closely approximates the bona fide investment than the fictitious and largely inflated book figures.

The court below accepted the same inflated book figures as the master had done, for valuation purposes. Its experience with the unjustifiable claims of expense should have put the court on guard, for the extravagant claims of respondent are only exceeded by its greed for the money of its consumers.

In its complaint, it was contended that "your orator was possessed of going value and other tangible assets of great value" and that $12,000,000 should be added to the value of your orator's tangible property, as going value. (Par. XII, p. 4A).

This extravagant claim shows its habits of thought and mind. Nothing was heard of it on the trial. Perhaps its own counsel was appalled at the enormity of the demands. It abandoned its $12,000,000 valuation without ceremony. On the direct case, it advanced its claim of the valuation made in the prior suit with additions and withdrawals. This finesse met with no great favor from the liberal master. Such extravagant claim, he indicated, could not be accepted by him. On rebuttal, it advanced its books figures as a basis of valuation, and content with their acceptance, makes no assignment of error in this court, but fondly hopes that it has at last furnished some evidence of value, satisfactory to the court and to itself.

The learned court below, wearied in the task of paring to reach the merit of the propositions, accepted the book figures and seeks to justify their acceptance. First, he indicates clearly in his opinion that the rule of present reproduction cost appears to him to have been either expressly or

impliedly recognized in all cases in which the Supreme Court has passed on the matters. It is clear that the present reproduction value met with his approval as a basis of "fair value."

He checks the book figures accepted by him by the cost of building the new Astoria unit, stating that such a check "is curiously conclusive at least to me."

He continues:

> "The contract was let in December, 1919, and forms a good test of what the costs then were of such units, better probably than the opinions of witnesses." (p. 177a.)

Again:

> "The book cost is a little short of five million dollars, a surprisingly close parallel. Therefore, judged upon the basis of their present capacity, I may assume that the reproduction value of the Manhattan plants is at least their book value." (pp. 177a, 178a.)

Convinced that the present reproduction cost is the proper basis of "fair value," the court finds a "surprisingly close parallel" between the book figures and the cost of reproduction in the abnormal year of 1919. This fact leads to their acceptance as the basis of the "fair value" of the property of the respondent.

The source of the accepted figures becomes immaterial. Because the figure closely approximates the present reproduction cost, is enough to lead to its adoption by the court below.

It is conclusive that the District Court attempted to reach an actual present reproduction cost instead of relying upon the testimony of expert witnesses, by his comment upon depreciation. He states:

> "If the proper standard for a rate base is the present cost of a substitute plant of equal capacity, *as I believe*, depreciation can be a function of it only in case the allowance for renewals to the plant under consideration will in the future be greater than that of the assumed standard" (p. 146a).

The learned court following his theory that depreciation should not be deducted from the present cost of reproduction, makes no allowance in this case for depreciation. He confesses, however, that depreciation should be deducted from the original cost (pp. 146a-147a).

After clearly pointing out the various elements upon which to base "fair value" in the leading case of *Smyth* v. *Ames*, 169 U. S., 466, which case has been approved and followed by nearly every court and Public Utility Commission in our land, we cannot conceive that at this late day, this court will lay down the rule that any figures or set of figures, from whatever source, having a surprisingly close parallel with the cost of reproduction new in the abnormal and unprecedented year of 1919, is any indication of the "fair value" of property in a confiscatory case. As we view it, such a rule must be adopted to sustain the acceptance of the grossly inflated book figures submitted by the respondent.

Contingency Fund.

We have called attention in our main brief to the fund of $11,801,659.48 acumulated by the company from operating revenues in prior years and that this fund should respond to any falling off in income during lean years. (pp. 157-163).

Respondent, in its reply brief, has not answered our contention. The amount of this fund is erron-

eously in the rate base, for the consumers created this fund, and ought not to be made to pay a return thereon again.

On the trial, the master expressed the view that if the company had set up a reserve to take care of lean and disastrous years, then no relief should be given. (p. 11614).

Working Capital.

The respondent, in its brief (p. 305) states that the allowance for working capital in the prior suit was $3,616,000 and (p. 306) that "the 1906 allowance approved by this court was $3,616,000."

This fairly illustrates the unreliability of the figures and the many careless statements contained in the respondent's brief. We quote from the record in that case (157 Fed. Rep. 849, p. 859) "A fair working capital for complainant is one million six hundred and sixteen thousand dollars, and that figure is adopted."

The court below, in fixing the amount for working capital in the instant case, should have taken into consideration that this company has now on hand about $450,000 accumulated during the prior suit and still unreturned to its consumers. (pp. 2943-2948). This large sum, together with the decision of Judge Hough in the prior suit, undoubtedly led the court to conclude that $2,000,000 was sufficient for the complainant alone. We reiterate any allowance in exces of $1,300,000 is not justified.

Unaccounted for Gas.

The voluminous brief of the appellee is undoubtedly accounted for by the fact that it assumes that it is the appellant in the instant case, and has filed before this court assignment of errors on almost

every conceivable question. To illustrate: pages 256-266, inclusive, of its brief, are devoted entirely to the question of unaccounted for gas which has been conclusively settled by the decision of the court below, and there is now no question before this court on any assignment of errors by the respondent.

The master found 7% unaccounted for (47th finding, p. 35a, and 53a). The court below reduced this to 4.12% during the period of 1906 to 1918, inclusive, slightly more than the average reported to the public authorities by the company for the years 1906-1918, inclusive. (p.153a).

The unaccounted for gas ought not to exceed the figure reported to the public authorities by the company, and even in this the court has allowed more than such an average as reported by the company which was 4.09%, as we have stated. (Defts. Ex. AA122, Table 157, p.10321).

The Court Below Had Too Little Time to Decide the Issues.

The many errors committed by the court below and which have been pointed out in appellants' main brief, were undoubtedly due to the fact that Judge Hand did not and could not, within the time he had the case, read the entire record, or give that mature deliberation and study to the many doubtful items to which the appellants directed attention both upon the oral argument and in its brief submitted to him.

Judge Hand stated frankly, when the oral argument was made before him,

> "I don't want to examine the record unless I am absolutely obliged to."

The argument took place on July 6, 1920, and the decision of Judge Hand was filed on August 4, 1920. The court below therefore had the case less than a month and disposed of that and other cases just preparatory to his going on his summer vacation.

We respectfully submit that it was unfair to the half million consumers in this case to dispose of it in such a hurried manner. Especially so in a case of such vast importance, and which perhaps will be the pioneer case in an attempt to destroy a statute of the State upon the returns shown in one or two abnormal years and a period so extraordinary that it probably never will be repeated again in the history of our country.

The Decision Below Disregards the Fundamental Rules Settled by This Court.

If the decision of the court below is upheld the rules laid down in many of the leading decisions governing confiscatory cases will be overruled. The court below, as we pointed out in our main brief, failed to follow the decision of this court in the *Minnesota Rate Cases*, 230 U. S. 352, in that it offset appreciation against depreciation.

Mr. Justice Hughes, writing for the court in that case, on this subject, says (p. 456-457):

> "But it was found that this depreciation was more than offset by appreciation. * * * We cannot approve this disposition of the matter of depreciation. * * * The extent of existing depreciation should be shown and deducted. * * * If there are items entering into the estimate of cost which should be credited with appreciation, this also should appear so that instead of a broad comparison there should be specific findings showing the

> items which enter into the account of physical valuation on both sides."

The decision of this court in the case of *Knoxville* v. *Knoxville Water Co.*, 212 U. S., 1, wherein this court held that it would not base confiscation on one year when it was shown that the year was abnormal is also apparently overruled. The court below based its decision upon evidence covering 1918 and the first 8 months of 1919, although it was shown that such period was abnormal.

Furthermore, the court below overruled the many cases in this and other courts holding that depreciation should be deducted, in fixing the fair value of a public utilities company's property in cases of this kind.

The Court disregarded the rule laid down by the Supreme Court of the State of New York in the case of Kings County Lighting Co. v. Lewis, 110 Misc., 304, wherein it was held by Mr. Justice Greenbaum, that

> "The operations of a fiscal year which was as abnormal as was the year 1918, lacked the value of a normal year in determining the future."

and in that case Mr. Justice Greenbaum, refused to base confiscation upon the returns shown in such an abnormal and extraordinary year. That was the rule adopted by the Supreme Court of the State of New York previous to the decision in the instant case.

The result of the erroneous rules applied in the instant case has led the various masters and judges in the same District Court to follow Judge Hand's decision in subsequent confiscatory cases. Appeals in these cases are now pending in this Court.

Cost of Operations Beyond August 31, 1919.

Respondent makes reference several times in its brief to the cost of operations in the last few months of 1919, and in 1920 and 1921. There is before this court no competent evidence of such cost. It is true that respondent and its counsel repeatedly endeavored to get before this court in the form of affidavits, alleged results of operations down to February, 1921, without any opportunity on the part of the defendants to combat its figures. Any alleged cost during such period are merely the ex-parte and self-serving figures of respondent and entitled to no consideration here. These figures contain improper items, items disallowed by the master and the court below, and the whole is subject to the same criticism made by the court concerning the company's 1918 and 1919 figures, and by appellants in their main briefs on this appeal.

In our brief in appeals Nos. 258 and 288 we have shown the startling fall in prices in gas oil, coal, etc. since the decree was entered in this case.

As a matter of fact respondent was given ample opportunity by the master to present operating cost, etc., covering the entire year of 1919, but did not care to present such evidence. (p. 14257.) The master even invited respondent to make an application to open its case so that its proof might cover the year of 1919, and suggested that if such an application were made he would grant it. (p. 14257.) The appellants objected to the proof as not proper rebuttal, not because they feared the results if it were adduced but because they felt that the trial, by reason of respondent's tactics had already been unduly protracted.

We object here to the bringing of extraneous

matters before this court and matters not the subject of proof in this record, as to the trend of prices since the decision of the Court below, again not because we fear the result of a fair inquiry into the unprecedented fall of prices but because we feel that this case should be decided upon its own record.

Perhaps the most grievous error committed by the learned Court below was that it failed to confine itself to the proven facts. The period upon which it based its finding is not the period covered by the proofs in this case. The period from July 1, 1906 to December 31, 1917, as to which proof was taken is disregarded. To the short period from January 1, 1918 to August 31, 1919, as to which the proofs were considered the Court below added practically a year covered by no evidence. As to this period it erroneously alleges (p. 143a) as excuse for considering matters not proven that "*evidence is not necessary* in the face of so patent and obtrusive a fact of daily life" as the increasing prices. We respectfully but none the less vigorously protest that evidence is always necessary in a court of law. If the solemn enactments of the Legislature of a soverign state are to be overthrown and nullified, without proof, on the Court's construction of the "facts of daily life," then is the sanctity of law become a memory and the courts of equity forms of conjecture not of justice.

AS STATED IN OUR MAIN BRIEF THE DECREES APPEALED FROM SHOULD BE REVERSED AND THE BILL OF COMPLAINT DISMISSED WITH COSTS.

Dated, New York, November 9th, 1921.

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